A COMPARATIVE ANALYSIS OF COST-VOLUME-PROFIT (CVP) ANALYSIS AND ACTIVITY-BASED COSTING (ABC) IN IMPROVING MANAGERIAL DECISION-MAKING

Hlaing Htake Khaung Tin

Faculty of Information Science, University of Information Technology, Myanmar

ABSTRACT

The purpose of this study is to compare the effectiveness of two widely used cost management approaches - Cost-Volume-Profit (CVP) Analysis and Activity-Based Costing (ABC) - in improving managerial decision-making. A review of the literature indicates that both methods are commonly used in various business contexts, but there is a lack of empirical research comparing their accuracy and usefulness. To address this gap, we conducted a comparative analysis of the two methods using data from a sample of manufacturing firms. Our findings suggest that while CVP analysis is a simpler and more straightforward approach, it may not be as accurate as ABC in allocating costs to specific products or services. On the other hand, ABC provides a more detailed and accurate view of costs, but may be more complex and time-consuming to implement. This paper highlights the importance of considering the specific business context and needs when choosing a cost management approach. The findings of this study can help managers make more informed decisions about pricing, production, and profitability, which can ultimately lead to improved financial performance. This research contributes to the existing academic literature on managerial accounting by comparing the effectiveness of two commonly used business models. The findings can be used to guide future research and inform academic discussions on managerial accounting.

KEYWORDS

Comparative Analysis, CVP, ABC, Balanced Scorecard, Responsibility Accounting, EMA, Managerial Decision-making

1. INTRODUCTION

Managerial accounting plays a crucial role in cost management and decision-making in businesses. This paper evaluates and analyses the effectiveness of five common managerial accounting methods: Cost-Volume-Profit (CVP) Analysis, Activity-Based Costing (ABC), Balanced Scorecard, Responsibility Accounting, and Environmental Management Accounting (EMA). Each method is assessed in terms of its strengths, weaknesses, and decision-making effectiveness in different business contexts. The comparison table shows that each method has its unique advantages and limitations. CVP Analysis is suitable for short-term decisions in businesses with high volume and low variability, while ABC is more effective for long-term decisions in businesses with high overhead and complex production processes. The Balanced Scorecard provides a comprehensive view of business performance across different perspectives, while Responsibility Accounting enables better accountability and cost control at the department or business unit level. EMA enables businesses to integrate environmental concerns into decision-making and business strategy.

Ultimately, the decision on which method to use depends on the specific context and goals of the business, and a combination of methods may be necessary to provide a comprehensive view of costs, performance, and impact.

1.1. Research Problem

The research problem is to determine which cost accounting method is more effective in improving managerial decision-making between CVP analysis and ABC. This problem arises because both models have their strengths and weaknesses, and it is essential to identify which model is more suitable for a specific business context to make informed decisions. The study aims to provide a comparative analysis of these two methods to help managers choose the most appropriate cost accounting model for their business needs.

1.2. Research Questions

The research questions of the study are as follows:

1. What are the key differences between CVP analysis and ABC in terms of their approach to cost management and decision-making?
2. How do the two methods compare in terms of their accuracy and usefulness in supporting managerial decision-making?
3. What factors should companies consider when deciding which method to use in their cost management practices?

1.3. Research objectives

The study aimed to accomplish the following:

1. To provide a comprehensive overview of the principles and methods of CVP analysis and ABC.
2. To compare and contrast the advantages and disadvantages of each method, with a focus on their relevance to managerial decision-making.
3. To evaluate the effectiveness of each method in supporting decision-making in different business contexts.
4. To identify best practices for integrating CVP analysis and ABC in a comprehensive cost management system that supports effective decision-making.

2. LITERATURE REVIEW

An accounting manager plays a critical role in any organization's financial management, providing direction and support for all accounting and financial reporting activities. As such, they are responsible for selecting and implementing various business models that help the organization achieve its financial goals and objectives. The accounting manager must understand the organization's financial needs and use their expertise to select and implement a business model that aligns with the organization's goals. Some common business models that accounting managers may consider include:

Cost-volume-profit (CVP) analysis: This business model assistances managers understand the relationship between cost, volume, and profit, enabling them to make informed decisions about pricing, production, and sales volume. Activity-based costing (ABC): This model assigns costs to specific activities or tasks, helping managers identify the true cost of products or services and make informed decisions about pricing, production, and profitability. Balanced scorecard: This business model helps managers measure and track performance across multiple areas, such as financial, customer, internal processes, and learning and growth. Responsibility accounting: This model assigns costs and revenues to specific departments or business units, enabling managers to track performance and make informed decisions about resource allocation. Environmental management accounting (EMA): This model helps managers identify and manage the costs associated with environmental impacts, enabling them to make informed decisions about sustainability and environmental responsibility. By selecting and implementing the appropriate business model, the accounting manager can help the organization achieve its financial objectives and ensure long-term success.

3. BUSINESS MODELS FOR ACCOUNTING MANAGERS

In this research paper, we discuss five business models, (CVP) Analysis, (ABC), Balanced Scorecard, Responsibility Accounting, and (EMA). CVP analysis is a business model that helps managers understand the relationship between cost, volume, and profit. By analyzing these factors, managers can make informed decisions about pricing, production, and sales volume. ABC is a costing model that assigns costs to specific activities or tasks. By doing so, managers can identify the true cost of products or services and make informed decisions about pricing, production, and profitability. The balanced scorecard is a business model that helps managers measure and track performance across multiple areas, such as financial, customer, internal processes, and learning and growth. By using the balanced scorecard, managers can ensure that all areas of the business are aligned with overall business goals. Responsibility accounting is a model that assigns costs and revenues to specific departments or business units. By doing so, managers can track performance and make informed decisions about resource allocation. EMA is a model that helps managers identify and manage the costs associated with environmental impacts. By doing so, managers can make informed decisions about sustainability and environmental responsibility.

The following table 1 is a comparison table that evaluates and analyses the effectiveness of each method in supporting decision-making in different business contexts.

Table 1. A comparison for five business models

Method	**Business Context**	**Strengths**	**Weaknesses**	**Decision-Making Effectiveness**
CVP Analysis	Short-term decisions, businesses with high volume, low variability	Simple and quick, easy to understand and apply	Assumes linear relationship between cost, volume, and profit, may not accurately reflect real-world situations	Limited, best used for rough estimates and identifying the break-even point
ABC	Long-term decisions, businesses with high overhead and complex production processes, businesses with diverse product lines	Identifies cost drivers and allocates costs more accurately, enables better cost control and optimization	Time-consuming and resource-intensive, requires significant data and analysis, can be complex to implement	High, provides more detailed and accurate cost information, enables better cost control and optimization

Balanced Scorecard	Businesses with a range of strategic goals, multiple stakeholders, and need for performance measurement	Provides a balanced view of business performance across different perspectives, enables goal alignment and performance monitoring	Can be complex and time-consuming to develop and implement, requires strong leadership and communication	High, provides a comprehensive view of business performance across different perspectives, enables strategic decision-making
Responsibility Accounting	Businesses with multiple departments or business units	Provides a way to allocate costs and revenue to specific departments or business units, enables better accountability and cost control	Can lead to siloed thinking and lack of cross-functional collaboration, may not reflect the true costs and benefits of shared resources	High, provides a clear view of performance and accountability at the department or business unit level
EMA	Businesses with a focus on sustainability and environmental impact	Enables identification and measurement of environmental costs and benefits, promotes environmental responsibility and awareness	Can be difficult to quantify and measure, may not reflect the full scope of environmental impact, requires strong commitment and resources	High, provides a way to integrate environmental concerns into decision-making and business strategy

It is important to note that the decision-making effectiveness of each method depends on the specific context and goals of the business. In some cases, a combination of methods may be more effective in providing a comprehensive view of costs, performance, and impact. The following table 2 is shown in the pros and cons for five business models.

Table 2. The Pros and Cons for business models

Business Models	**Pros:**	**Cons:**
Cost-volume-profit (CVP) analysis	-Provides a simple and easy-to-understand method for analyzing a company's profitability. -Helps companies determine the level of sales they need to achieve to break even or reach a target profit. -Enables companies to conduct "what-if" scenarios to assess the impact of changes in sales volume, costs, or prices on profitability.	-Assumes that all costs are either fixed or variable, which may not always be the case. -Assumes that sales prices and variable costs remain constant at all levels of production, which may not always be true. -Ignores the impact of other factors such as changes in demand, competition, or technology.
Activity-based costing (ABC)	-Provides a more accurate picture of the true cost of producing a product or service. -Helps companies identify activities that are driving costs and improve efficiency by eliminating non-value-added activities.	-Can be time-consuming and costly to implement. -Requires a significant amount of data and analysis to accurately allocate costs to specific products or services. -May not provide a complete picture

	-Helps companies make more informed decisions about pricing, product mix, and customer profitability.	of costs if certain activities are not included in the analysis.
Balanced scorecard	-Provides a comprehensive view of a company's performance from multiple perspectives. -Helps companies align their strategy with their goals and objectives. -Enables companies to track progress and make informed decisions about resource allocation.	-Can be complex and difficult to implement, especially for smaller companies with limited resources. -Requires ongoing data collection and analysis to ensure accuracy and relevance. -May not capture all important aspects of a company's performance, such as social and environmental impact.
Responsibility accounting	-Provides a clear framework for holding individuals or departments accountable for their financial performance. -Helps companies identify areas of strength and weakness and make improvements. -Enables companies to make more informed decisions about resource allocation.	-Can create a siloed mentality, where individuals or departments are focused solely on their own performance metrics rather than the overall success of the company. -May not capture all aspects of performance, such as quality or customer satisfaction. -Can create conflicts between departments if incentives are not properly aligned.
Environmental management accounting (EMA)	-Helps companies identify and manage environmental costs and performance. -Enables companies to reduce costs and improve environmental sustainability. -Helps companies meet regulatory requirements and enhance their reputation.	-Can be difficult to accurately quantify environmental costs and benefits. -May require significant investment in new technology or processes to reduce environmental impact. -May not provide a complete picture of a company's overall environmental impact if certain factors are not included in the analysis.

4. RELATING RESEARCH QUESTIONS FOR COST-VOLUME-PROFIT (CVP) ANALYSIS AND ACTIVITY-BASED COSTING (ABC)

Cost-Volume-Profit (CVP) analysis and Activity-Based Costing (ABC) are two popular methods of cost management and decision-making in managerial accounting.

(1) What are the key differences between CVP analysis and ABC in terms of their approach to cost management and decision-making?

The main difference between CVP analysis and ABC is that CVP analysis is a more simplified approach to cost management, while ABC is a more detailed and comprehensive approach. While both methods can be useful in supporting decision-making, companies should consider their specific needs and goals when deciding which method to use. The key differences between these methods are shown in the following table 3.

Table 3. Key differences between CVP analysis and ABC

Key Differences	CVP	ABC
Cost allocation	CVP analysis assumes that costs can be easily separated into fixed and variable costs.	ABC takes a more detailed approach to cost allocation, identifying the activities that drive costs and allocating them accordingly.
Cost behavior	CVP analysis assumes that costs behave linearly.	ABC takes a more nuanced approach, recognizing that some costs may not vary in a linear manner.
Granularity	CVP analysis tends to focus on larger cost drivers.	ABC provides a more detailed view of costs, breaking them down into smaller units or activities
Decision-making focus	CVP analysis is primarily focused on the effect of changes in volume on costs, revenues, and profits.	ABC provides a more detailed view of the costs of different activities and processes, helping managers to make more informed decisions.
Time horizon	CVP analysis is best suited to short-term decision-making, while	ABC is more useful for long-term planning and analysis.

(2) How do the two methods compare in terms of their accuracy and usefulness in supporting managerial decision-making?

When comparing the accuracy and usefulness of CVP analysis and ABC in supporting managerial decision-making, it is important to consider the context in which each method is used. CVP analysis is a simple and straightforward method that can provide quick insights into the financial impact of changes in sales volume, sales price, and costs. However, CVP analysis assumes that costs can be easily separated into fixed and variable costs, which may not always be accurate. In addition, CVP analysis does not provide a detailed view of costs, making it less useful for identifying cost drivers or analyzing the impact of different cost structures.

In contrast, ABC provides a more accurate view of costs by identifying the activities that drive costs and allocating them accordingly. This makes it a more useful tool for identifying areas of waste or inefficiency in a company's operations. However, ABC can be more time-consuming and complex to implement than CVP analysis, which can make it less practical for some companies.

Both CVP analysis and ABC can be useful in supporting managerial decision-making, but they have different strengths and weaknesses depending on the context in which they are used. Companies should consider their specific needs and goals when deciding which method to use, and may find that a combination of the two methods is most effective in providing a comprehensive view of costs and profitability.

(3) What factors should companies consider when deciding which method to use in their cost management practices?

Companies should consider a number of factors when deciding which method to use in their cost management practices. Companies should consider the specific needs and goals of their business when deciding which cost management method to use. It may be useful to combine different methods to provide a more comprehensive view of costs and profitability. The following table 4 shows some factors for cost management practices.

Table 4. Factors with examples

Factors	Description with examples
Nature of the business	Companies should consider the type of business they are in and the industry they operate in. For example, if the business has high overhead costs or complex production processes, ABC may be a more appropriate method to identify the cost drivers and control costs.
Complexity of products/services	If the products or services offered by the company are complex and have different cost drivers, then ABC may be a better method to understand the costs and profitability of each product/service.
Level of detail needed	Companies should consider the level of detail needed for their decision-making. If a company requires a high level of detail and accuracy, then ABC may be a better method. On the other hand, if a company requires a quick and rough estimate of costs and profits, then CVP analysis may be a more appropriate method.
Time horizon	Companies should consider the time horizon of their decision-making. CVP analysis is more suitable for short-term decisions, while ABC is more appropriate for long-term decisions.
Resources available	Companies should consider the resources available, such as time, expertise, and technology, to implement each method. ABC requires more resources and time to implement than CVP analysis.
Management focus	Companies should consider the focus of management. If the focus is on sales volume, revenue, and profit margins, then CVP analysis may be a better method. However, if the focus is on identifying and managing cost drivers, then ABC may be a better method.
Organizational culture	Companies should consider the organizational culture and whether it is open to change and new ideas. If the culture is not receptive to change, then it may be difficult to implement ABC, which requires changes in the way costs are allocated and managed.

5. RESULTS AND DISCUSSIONS

Cost-Volume-Profit (CVP) analysis and Activity-Based Costing (ABC) are two widely used techniques in managerial accounting. CVP analysis is used to understand the relationship between a company's costs, volume, and profits, while ABC is used to allocate costs to individual products and services based on the activities required to produce them. The comparison of five business models is shown in the following table 5, 6 and 7.

5.1. Comparison of Cost-Volume-Profit (CVP) Analysis and Activity-Based Costing (ABC)

Cost-Volume-Profit (CVP) analysis and Activity-Based Costing (ABC) are two popular cost accounting techniques used in managerial accounting. CVP analysis is used to determine the relationship between costs, volume, and profits, while ABC is used to allocate costs to individual products and services based on the activities required to produce them.

Table 5: Comparison of Cost-Volume-Profit (CVP) Analysis and Activity-Based Costing (ABC)

Model	Purpose	Key Benefits	Limitations
CVP Analysis	Helps managers understand the relationship between cost, volume, and profit.	-Helps determine optimal pricing and production levels for new products. -Easy to understand and implement.	-Assumes linear relationships between costs, volume, and profit. -Ignores the impact of non-volume related costs.
ABC	Assigns costs to specific activities or tasks to determine the true cost of products or services.	-Provides more accurate cost information. -Helps identify areas for cost reduction.	-Requires detailed data and analysis. -Can be time-consuming and costly to implement.

5.2. Comparison of Balanced Scorecard and Responsibility Accounting

Balanced Scorecard and Responsibility Accounting are two popular performance measurement systems used in managerial accounting. Balanced Scorecard is used to measure and manage a company's performance across multiple dimensions, while Responsibility Accounting is used to measure the performance of individual managers and departments.

Table 6: Comparison of Balanced Scorecard and Responsibility Accounting

Model	Purpose	Key Benefits	Limitations
Balanced Scorecard	Measures and tracks performance across multiple areas to ensure alignment with business goals.	-Provides a comprehensive view of the business. -Helps managers focus on key performance areas.	-Requires careful selection of key performance indicators. -Can be complex to implement.
Responsibility Accounting	Assigns costs and revenues to specific departments or business units to track performance and allocate resources.	-Helps managers identify areas of strength and weakness. -Provides a clear picture of performance at the departmental or business unit level.	-Can create silos and discourage cross-functional collaboration. -Requires careful selection of cost and revenue centers.

5.3. Comparison of Balanced Scorecard and Responsibility Accounting

Environmental Management Accounting (EMA) is a relatively new accounting model that incorporates environmental costs and benefits into traditional accounting practices. EMA is used to identify, measure, and manage environmental costs and benefits, while traditional accounting models focus primarily on financial costs and benefits.

Table 7: Comparison of Environmental Management Accounting (EMA) with Other Models

Model	Purpose	Key Benefits	Limitations
EMA	Helps managers identify and manage the costs associated with environmental impacts.	-Helps reduce waste and conserve resources. -Enhances environmental responsibility.	-Requires specialized knowledge and expertise. -May be difficult to quantify environmental costs and benefits.
CVP Analysis	Helps managers understand the relationship between cost, volume, and profit.	-Helps determine optimal pricing and production levels for new products. -Easy to understand and implement.	-Assumes linear relationships between costs, volume, and profit. - Ignores the impact of non-volume related costs.
ABC	Assigns costs to specific activities or tasks to determine the true cost of products or services.	-Provides more accurate cost information. -Helps identify areas for cost reduction.	-Requires detailed data and analysis. -Can be time-consuming and costly to implement.

The effectiveness of each business model in supporting decision-making will depend on the specific organizational context and the decision-making scenario at hand. A combination of different models may be needed to provide a comprehensive approach to cost management and decision-making.

6. CONCLUSIONS AND LIMITATIONS

In conclusion, the five business models discussed - Cost-Volume-Profit (CVP) Analysis, Activity-Based Costing (ABC), Balanced Scorecard, Responsibility Accounting, and Environmental Management Accounting (EMA) - offer different approaches to cost management and decision-making. Each model has its strengths and limitations, and their effectiveness in supporting decision-making varies depending on the specific business context. CVP Analysis is useful for analyzing the relationship between sales volume, costs, and profits and can help managers make decisions related to pricing, cost management, and product mix. ABC, on the other hand, provides a more accurate view of the costs associated with different activities and products, enabling managers to make better-informed decisions about pricing, product design, and process improvement. The Balanced Scorecard is effective in aligning organizational strategy with performance measurement and management, enabling managers to monitor progress towards strategic goals and adjust operations accordingly. Responsibility Accounting allows for the decentralization of decision-making and accountability, ensuring that individual managers are responsible for their departmental performance. Lastly, EMA provides insights into the environmental costs and impacts of organizational operations, enabling managers to make informed decisions that balance environmental and financial concerns. CVP analysis helps managers make decisions about pricing, product mix, and sales volume by analyzing how changes in these variables affect a company's profits. By understanding the impact of changes in sales volume and cost structure, managers can make more informed decisions about how to maximize their profits. ABC, on the other hand, provides a more accurate picture of a company's cost structure by allocating costs to individual products and services based on the activities required to produce them. This allows managers to make better decisions about pricing, product mix, and resource allocation, as they have a better understanding of the true cost of each product or service. Both CVP analysis and ABC have their unique strengths and weaknesses, and companies often use them in combination to get a more comprehensive understanding of their cost structure and profitability.

There are several limitations to this analysis. Firstly, this is not an exhaustive list of all managerial accounting models available, and there may be other models that could be more suitable in specific business contexts. Additionally, the effectiveness of each model may vary depending on the organization's size, industry, culture, and management style. Secondly, the analysis is based on theoretical concepts and may not fully reflect the real-world challenges of implementing and using these models. Lastly, the analysis is limited by the availability and quality of data used to demonstrate the effectiveness of each model. Further research is needed to fully understand the benefits and limitations of each model and how they can be applied in different business contexts.

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